

# SURVEY OF RECENT DEVELOPMENTS IN INSURANCE LAW

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## INTRODUCTION

During this survey period,<sup>1</sup> the Indiana Supreme Court decided a case that had been the topic of many insurance practitioners' discussions over the past year concerning the use of staff counsel by insurance companies. This case highlights a productive year of judicial decisions in the insurance field covering a variety of issues and subjects. This Article addresses the past year's cases and analyzes their effect on the practice of insurance law.

### I. INSURANCE COMPANY'S USE OF STAFF COUNSEL TO DEFEND INSURED

Indiana joined a number of states confronting the hotly debated issue of whether insurance companies may use staff counsel to represent their insureds who have been sued in *Cincinnati Insurance Co. v. Wills*.<sup>2</sup> The supreme court's decision will affect a number of different interests and parties. Not only are the insurance companies and their insureds affected, but the attorneys representing injured victims as plaintiffs will also be impacted by the *Wills* decision.

The *Wills* case started innocently enough as a personal injury lawsuit following an automobile accident between the injured victims and two defendants in Tippecanoe County. One of the defendants was insured by Celina Insurance Company.<sup>3</sup> Celina chose its house counsel, who was an employee of and paid by Celina, to represent the insured.<sup>4</sup> The insured was advised that the attorney's ethical obligations were owed solely to her and not Celina, and the insured consented to the attorney's representation.<sup>5</sup>

The injured victims filed a Motion to Disqualify the Celina staff attorney by contending that Celina engaged in the unauthorized practice of law by using staff counsel to represent their insureds.<sup>6</sup> Another insurer, Cincinnati Insurance Company, intervened in the lawsuit by claiming an interest in the outcome of the Motion to Disqualify because Cincinnati Insurance used a "captive law firm"

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1. The survey period for this Article is approximately September 1, 1998 to October 6, 1999.

2. 717 N.E.2d 151 (Ind. 1999).

3. *See id.* at 153.

4. *See id.*

5. *See id.*

6. *See id.* The unauthorized practice of law is prohibited. *See* IND. CODE § 33-1-5-1 (1998).

through Berlon & Timmel.<sup>7</sup> Berlon and Timmel's attorneys were employees of Cincinnati Insurance, working solely on cases involving the company or its insureds.<sup>8</sup>

The trial court concluded that Celina engaged in the unauthorized practice of law by using staff counsel to represent insureds and that the specific attorney employed by Celina violated Rule of Professional Conduct 5.5 prohibiting a lawyer from assisting a person in the unauthorized practice of law.<sup>9</sup> The trial court also concluded that Cincinnati Insurance engaged in the unauthorized practice of law by its use of a "captive law firm" and that the use of the firm name "Berlon & Timmel" was a deceptive practice.<sup>10</sup> The trial court ordered that both Celina and Cincinnati cease all efforts to engage in the unauthorized practice of law and that Berlon & Timmel's local office should be closed.<sup>11</sup> The insurers immediately filed a motion with the court of appeals to stay the trial court's orders, which was granted.<sup>12</sup> An appeal was then filed directly to the Indiana Supreme Court.<sup>13</sup>

The supreme court engaged in an extensive analysis of the issues presented and were afforded a number of briefs by amici.<sup>14</sup> In addressing these questions, the supreme court decided that the insurers did not engage in the unauthorized practice of law by using staff counsel to represent insureds.<sup>15</sup> While the court concluded that the insurance company as a corporation could not practice law, the court found that the corporation's employment of attorneys, who were bound by the ethical rules, did not result in the unauthorized practice of law.<sup>16</sup> Furthermore, the court decided that while the staff counsel's joint representation of the insurance company and its insureds could present a problem in certain situations, there was no inherent conflict to create a rule of prohibition in all cases.<sup>17</sup>

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7. See *Wills*, 717 N.E.2d at 153.

8. See *id.* Berlon & Timmel would represent both Cincinnati Insurance in first party claims and its insureds in third party claims. See *id.*

9. See *id.* Indiana Rule of Professional Conduct 5.5 states that "A lawyer shall not: . . . (b) assist a person who is not a member of the bar in the performance of activity that constitutes the unauthorized practice of law." IND. PROF. COND. R. 5.5 (2000).

10. *Wills*, 717 N.E.2d at 153-54. The trial court relied upon Indiana Rule of Professional Conduct 7.2 which requires that a lawyer "not practice under a name that is misleading as to the identity, responsibility, or status of those practicing thereunder, or is otherwise false, fraudulent, misleading, deceptive. . . ." *Id.* at 164.

11. See *id.* at 154.

12. See *id.*

13. See *id.*

14. The amici parties included not only insurance companies, but charitable organizations and business trade organizations concerned about the effects of a decision forbidding their use of staff counsel. See *id.* at 153.

15. See *id.* at 155.

16. See *id.* at 160.

17. See *id.* at 161.

As to the order prohibiting Berlon & Timmel from continuing to practice as a captive law firm, the supreme court agreed with the trial court that the name was misleading.<sup>18</sup> The use of a law firm name by Cincinnati Insurance presented an appearance that the firm was independent such that the ordinary person would assume the firm to be "outside counsel."<sup>19</sup> The supreme court recognized that the use of "captive law firms" was permissible.<sup>20</sup> However, it ordered Cincinnati Insurance to discontinue the use of the "Berlon & Timmel" name and instead use a name describing their attorneys as employees of the insurance company.<sup>21</sup>

The immediate effect of the *Wills* decision is that insurance companies, who formerly relied upon outside defense counsel to represent their insureds, may now hire staff counsel to perform those functions. Insurers believe that they save money on defense costs by using their own staff counsel. Attorneys representing injured victims are also affected by this decision for the same reason. On small personal injury lawsuits, plaintiff attorneys cannot contend during settlement negotiations that the case has a "nuisance" settlement value because the insurance company will incur defense costs to proceed to trial. Insurers can respond that there are no additional defense costs for them in representing the insured because their staff counsel is on salary.

The question remains for insurance companies as to whether the use of staff counsel or captive law firms will produce better results. The insurance companies' use of staff counsel will most likely produce an offspring of cases where it is alleged that the insurance company commits bad faith. For example, if the insurance company employs staff counsel to represent an insured and a demand for policy limits to settle the claim is made, the insurance company must notify its insured of the demand. If the insurance company proceeds to trial and a judgment in excess of the policy limits is awarded, there will be significant scrutiny of the staff counsel's decisions and actions to make sure the insured was fully and impartially informed and that the insurance company did not act for its own benefit to the detriment of its insured.

The ultimate benefit or detriment of the use of staff counsel will not be observable until many years of use have occurred. Thus, the *Wills* decision will be one that will impact the insurance industry for a number of years.

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18. *See id.* at 164.

19. *Id.* In its firm stationary, Berlon & Timmel included a statement at the bottom that stated "Berlon & Timmel is an unincorporated association, not a partnership, of individual licensed attorneys employed by The Cincinnati Insurance Company for the exclusive purpose of representing the Cincinnati Insurance Companies and their policyholders." *Id.* The supreme court found this disclaimer as insufficient to dispel the deceptiveness to an ordinary person. *See id.*

20. *Id.* at 165.

21. *See id.*

## II. AUTOMOBILE INSURANCE CASES

A. *Escape Clauses and Arbitration Award Challenges*

Two cases during the survey period analyzed the enforceability of "escape clauses" in insurance policies that allow the parties to challenge arbitration decisions even after both parties agreed to submit their dispute to arbitration. Both cases permitted a challenge to the arbitration awards despite a growing national trend finding "escape clauses" to be unenforceable.<sup>22</sup> Indiana's strong policy upholding parties' freedom to contract seemed to be the deciding factor for both courts in supporting the enforcement of the "escape clauses."

In *National General Insurance Co. v. Riddell*,<sup>23</sup> Riddell was insured under an automobile policy issued by National General.<sup>24</sup> In 1995, Riddell was seriously injured in an accident involving an uninsured motorist.<sup>25</sup> The parties agreed to submit the claim to arbitration, and an award was entered by the arbitrator in favor of Riddle for \$220,000, finding that the negligence of the uninsured motorist was the cause of the accident.<sup>26</sup>

National General appealed the arbitration award pursuant to the "escape clause" of the insurance policy.<sup>27</sup> Riddell sought and received summary judgment in the trial court, which held that the "escape clause" was illusory and void as against public policy.<sup>28</sup>

Discussing Indiana's policy to zealously defend the freedom to contract, the court of appeals reversed the trial court's summary judgment.<sup>29</sup> The court of appeals held that an "escape clause" allowing for appeal of an arbitration award of damages was enforceable, if the amount of damages awarded exceeded the statutory minimum for bodily injury liability as required by the policy.<sup>30</sup>

The second case to examine an "escape clause" in an insurance contract was *Allstate Insurance Co. v. Bradtmueller*.<sup>31</sup> In *Bradtmueller*, the insured, who was dissatisfied with an arbitration award she obtained on her claim for underinsured motorist benefits, brought a declaratory judgment action against Allstate.<sup>32</sup> Again, the facts were undisputed, leaving the court of appeals with essentially the

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22. The national trend against "escape clauses" finds them to provide illusory coverage so as to be void. See *National Gen. Ins. Co. v. Riddell*, 705 N.E.2d 465, 467 (Ind. Ct. App. 1998).

23. See *id.* at 465.

24. See *id.*

25. See *id.*

26. See *id.* at 466.

27. See *id.* The provision allowed the parties to appeal the award only if it exceeded the minimum limit for bodily injury pursuant to the state's financial responsibility statute.

28. See *id.*

29. See *id.* at 468.

30. See *id.*

31. 715 N.E.2d 993 (Ind. Ct. App. 1999), *trans. denied*, No. 02A03-9809-CV-377, 2000 Ind. LEXIS 284 (Ind. Mar. 23, 2000).

32. See *id.* at 994.

same question that was presented in *Riddell* of whether the "escape clause" in an insurance contract is enforceable to allow a party to avoid an arbitration award.

In November 1993, Bradtmueller was injured in an automobile accident involving an underinsured motorist and recovered the insurance policy limits from the tortfeasor's insurance company.<sup>33</sup> Bradtmueller sought additional benefits from Allstate, her underinsured motorist insurance company, but the parties were unable to agree as to the amount to which Bradtmueller was entitled.<sup>34</sup> The parties resorted to arbitration as prescribed in the insurance contract.<sup>35</sup>

After an unsatisfactory arbitration award was entered in her favor, Bradtmueller filed suit in the trial court seeking an appeal.<sup>36</sup> Allstate moved for summary judgment arguing that Bradtmueller was precluded from filing her action based upon the arbitration provision in the insurance contract.<sup>37</sup> The trial court denied Allstate's motion and the insurance company filed an interlocutory appeal.<sup>38</sup> Citing *Riddell*, the court of appeals upheld the trial court's denial of Allstate's motion, concluding that Bradtmueller could rely on the "escape clause" to bring her lawsuit against Allstate.<sup>39</sup>

These cases represent Indiana's awareness that the freedom to contract should not be impeded. The insurance policy permitted the parties to proceed to arbitration, but also recognized that the "escape clause" will permit appeals of those decisions under certain circumstances.

### B. *Intentional Acts Exclusion*

In *Coy v. National Insurance Ass'n*,<sup>40</sup> Robert Adams stole his grandmother's automobile that was insured by Robert's father with National.<sup>41</sup> Robert and his girlfriend, Melissa Coy, drove to North Carolina where they pulled away from a gas station without paying for their gas, prompting a high speed police chase.<sup>42</sup> The chase ended in an accident that killed Melissa, and Robert pled guilty to involuntary manslaughter.<sup>43</sup>

Melissa's mother sued Robert for negligence.<sup>44</sup> In turn, National filed a declaratory judgment action seeking a determination that Robert's actions were intentional, such that National did not owe any insurance coverage to Robert

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33. *See id.*

34. *See id.* at 995.

35. *See id.*

36. *See id.*

37. *See id.*

38. *See id.* at 999.

39. *See id.*

40. 713 N.E.2d 355 (Ind. Ct. App. 1999).

41. *See id.* at 358.

42. *See id.*

43. *See id.*

44. *See id.*

pursuant to the intentional acts exclusion of the policy.<sup>45</sup> National was initially granted summary judgment, but the trial court reversed its decision.<sup>46</sup> A bench trial occurred which resulted in the trial court determination that Robert's actions were intentional based upon his driving of over 100 miles per hour, passing vehicles in no passing zones, and crossing the center line in front of oncoming traffic.<sup>47</sup> Consequently, National did not owe insurance coverage for Robert's actions.<sup>48</sup>

On appeal, the court reversed the trial court by concluding there was no evidence showing Robert possessed either an actual or inferred intent to injure Melissa.<sup>49</sup> Robert testified that he did not intend to injure Melissa, such that actual intent did not exist.<sup>50</sup> The court refused to find that the reckless driving of Robert was sufficient to infer that he intended to cause injury to Melissa.<sup>51</sup> The court looked to other cases that held that reckless conduct did not satisfy a "practically certain" standard necessary to exclude coverage under the lesser "expected acts" provision of an insurance policy.<sup>52</sup> The court concluded that if Robert's reckless acts did not satisfy the lesser "expected" standard, then the higher "intended" standard could not be satisfied as well.<sup>53</sup> The court found that killing Melissa was not the intended result of Robert's actions, rather it was an unintended consequence of Robert's intentional act to evade the police.<sup>54</sup>

This case demonstrates the difficulties experienced by insurance companies in applying the "intentional acts" exclusion. In order to apply the exclusion, evidence must be procured to show that the act alone demonstrates an intent to injure, which may prove difficult in cases similar to *Coy*. In contrast, this required showing is met in sexual molestation cases<sup>55</sup> where the act of sexual molestation alone is sufficient to infer an intent to injure, triggering the "intentional acts" exclusion.

### C. Who Is an Insured?

The court, in *Thomas v. Victoria Fire & Casualty Insurance Co.*,<sup>56</sup> examined the definitional issues involved in determining who is covered under a policy of liability insurance. In *Thomas*, the named insured under the policy was driving

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45. The "intentional acts" provision excluded coverage for "bodily injury or property damage caused intentionally by or at the direction of the insured." *Id.* (citation omitted).

46. *See id.*

47. *See id.* at 359.

48. *See id.*

49. *See id.*

50. *See id.*

51. *See id.*

52. *Id.* (citing *Bolin v. State Farm Fire & Cas. Co.*, 557 N.E.2d 1084 (Ind. Ct. App. 1990)).

53. *Id.* at 360.

54. *See id.* at 358.

55. *See Wiseman v. Leming*, 574 N.E.2d 327 (Ind. Ct. App. 1991).

56. 706 N.E.2d 212 (Ind. Ct. App.), *trans. denied*, 726 N.E.2d 301 (Ind. 1999) (mem.).

a vehicle with a pregnant relative as a passenger.<sup>57</sup> They were involved in an accident with a car driven by an uninsured motorist.<sup>58</sup> The pregnant passenger and her unborn child were injured and sought uninsured motorist coverage for the injuries under the driver's insurance policy.<sup>59</sup>

Victoria denied coverage based on an exclusion in the liability portion of the policy, which precluded coverage for bodily injury to a relative of the named insured.<sup>60</sup> On appeal of the trial court's grant of summary judgment for the insurance company, the court of appeals found that the pregnant passenger was not entitled to benefits under the policy.<sup>61</sup> The passenger was technically within the definition of those covered under the uninsured motorist protection provision of the policy. However, in Indiana, before a person is entitled to uninsured motorist coverage, they must qualify as an insured under that policy who would receive liability coverage.<sup>62</sup> Because the pregnant passenger did not qualify as an insured under the liability coverage, there was no coverage available to her for the uninsured motorist claim.<sup>63</sup>

#### D. Bad Faith Issues

There seems to be a trend by Indiana plaintiffs to include a bad faith claim against the insurance carrier whenever a claim has been denied. Indiana case law has created a high burden upon plaintiffs to succeed on a bad faith claim against the insurance company.<sup>64</sup> Because of this high burden, insurance companies are often successful in obtaining summary judgment on the bad faith claim. During this survey period, the courts addressed situations where summary judgment is sought on a bad faith claim against an insurance company.

The court in *Gooch v. State Farm Mutual Auto Insurance Co.*,<sup>65</sup> reversed the

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57. *See id.* at 213.

58. *See id.*

59. *See id.* at 214.

60. The insurance company cited the policy which excluded coverage for bodily injury to the named insured and any relative. *See id.*

61. *See id.* at 215.

62. The rationale behind this policy is to reward those individuals who obtain liability coverage by limiting the scope of uninsured motorist coverage to those listed as insured under the policy, regardless of the policy's language. *See Anderson v. State Farm Mut. Auto. Ins. Co.*, 471 N.E.2d 1170 (Ind. Ct. App. 1984).

63. *See id.*

64. Generally, the insured must demonstrate that the insurance company denied a claim "knowing that there [was] no rational, principled basis for doing so." *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 520 (Ind. 1993). Furthermore, the courts have found that the insurance company must have possessed a culpable mental element showing "a state of mind reflecting dishonest purpose, moral obliquity, furtive design, or ill will." *Colley v. Indiana Farmers Mut. Ins. Group*, 691 N.E.2d 1259, 1261 (Ind. Ct. App.), *trans. denied*, 706 N.E.2d 167 (Ind. 1998).

65. 712 N.E.2d 38 (Ind. Ct. App. 1999), *trans. denied*, No. 49A02-9806-CV-479, 2000 Ind. LEXIS 136 (Ind. Feb. 16, 2000).

trial court's summary judgment order in favor of the insurer because it found genuine issues of material fact as to whether the insurer engaged in bad faith conduct. *Gooch* is an interesting case that examines whether an insurer's litigation conduct in defending itself against an uninsured motorist claim is admissible to determine whether the insurer made a bad faith attempt to force the insured to settle the claim.

In *Gooch*, the insured sued her automobile insurer in Indiana to recover uninsured motorist benefits after she was injured in an accident with a hit-and-run driver in Michigan.<sup>66</sup> State Farm advised Gooch to file her lawsuit in Michigan against the suspected hit-and-run driver so that State Farm could retain its subrogation rights.<sup>67</sup> Gooch explained to State Farm that the Michigan suspect had an alibi for the time of the accident and did not fit the description of the driver that she had provided to police.<sup>68</sup> Nonetheless, State Farm moved to dismiss Gooch's action in Indiana and insisted that the action be pursued in Michigan.<sup>69</sup>

Gooch amended her Indiana Complaint to allege bad faith by State Farm.<sup>70</sup> Later, Gooch also discovered that State Farm had a policy to litigate all low damage collisions in order to make it financially difficult for an insured to obtain a recovery.<sup>71</sup> Gooch argued that State Farm's litigation tactics of having her pursue litigation in an inconvenient forum and having a policy to litigate her type of claim were an unlawful attempt to force her to settle because she could not afford the litigation costs.<sup>72</sup>

The trial court granted State Farm's summary judgment motion on the bad faith claim and Gooch appealed.<sup>73</sup> Analyzing the facts within the framework enunciated in *Erie Insurance Co. v. Hickman*,<sup>74</sup> the court found that there was an issue of fact as to whether State Farm was exercising unfair advantage over the insured to pressure her to settle.<sup>75</sup>

A significant portion of this decision focused upon the court allowing evidence of State Farm's litigation conduct to prove bad faith.<sup>76</sup> The court concluded that certain actions by State Farm done after Gooch brought her lawsuit, were admissible to show that State Farm engaged in bad faith.<sup>77</sup> Thus, an issue of fact remained to warrant reversal of State Farm's summary

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66. *See id.* at 39.

67. *See id.*

68. *See id.*

69. *See id.*

70. *See id.*

71. *See id.*

72. *See id.*

73. *See id.*

74. 622 N.E.2d 515 (Ind. 1993).

75. *See Gooch*, 712 N.E.2d at 42.

76. *See id.* at 41-43.

77. *See id.* at 43.



judgment.<sup>78</sup>

A summary judgment to an insurer on a claim of bad faith was affirmed in *White v. State Farm Mutual Automobile Insurance Co.*<sup>79</sup> In *White*, the insured brought suit against State Farm for breach of contract and bad faith after State Farm refused to pay for all of the insured's chiropractic bills after submitting them to an independent medical review agency.<sup>80</sup> The essence of the insured's bad faith claim was that State Farm maintained no written guidelines or procedures to insure a proper medical review and payment of medical expenses, nor did State Farm properly supervise the payment process.<sup>81</sup>

The trial court granted summary judgment in favor of State Farm and the insured appealed.<sup>82</sup> The court of appeals agreed with the trial court by finding no designated evidence in the record that State Farm violated its duty to deal in good faith to the insured.<sup>83</sup>

Nevertheless, the court observed that if the insured presented evidence that State exercised disparate treatment in having chiropractic versus non-chiropractic cases reviewed by the medical review agency, then an issue of fact would remain on whether State Farm acted in bad faith.<sup>84</sup> Questions addressing insurance companies' use of medical review panels or institution of litigation policies on soft tissue cases will continue to provide decisions defining the scope of insurance company bad faith.

#### *E. Entitlement to Underinsured Motorist Coverage After Settlement with Tortfeasor*

In *Webster v. Pekin Insurance Co.*,<sup>85</sup> an insured was tendered the policy limits by a tortfeasor, and advised his underinsured motorist carrier of this fact to receive permission to proceed with the settlement.<sup>86</sup> The insurer never responded, and the insured settled with the tortfeasor by executing a release agreement.<sup>87</sup> When the insured sought underinsured motorist coverage, the insurer denied the claim by contending it was prejudiced by the insured's settlement with the tortfeasor in limiting its ability to seek subrogation for any amounts paid by the insurer.<sup>88</sup> The insured filed suit against the insurer and the

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78. *See id.*

79. 709 N.E.2d 1079 (Ind. Ct. App. 1999).

80. *See id.* at 1081.

81. *See id.*

82. *See id.*

83. *See id.* at 1084.

84. *See id.*

85. 713 N.E.2d 932 (Ind. Ct. App. 1999).

86. *See* IND. CODE § 27-7-5-6(b) (1998) (requiring an insurer, once it has received notice of a tortfeasor's tender of policy limits, to advance that amount to the insured to preserve its right of subrogation).

87. *See Webster*, 713 N.E.2d at 934.

88. *See id.*

agent who sold the policy to the insured, seeking the underinsured motorist coverage and alleging bad faith.<sup>89</sup>

On appeal, the court reversed the trial court's grant of summary judgment to the insurer and agent on both the breach of contract and the bad faith claims.<sup>90</sup> With respect to the bad faith claim, the court found that there was a question of fact as to whether the agent breached an oral promise to pay underinsured motorist benefits to the insured.<sup>91</sup> As to the claim for uninsured motorist coverage, the court reversed and ordered that summary judgment be entered against the insurance company, because it had waived its right to seek subrogation which nullified its argument that no coverage existed.<sup>92</sup>

#### F. Garage Liability Coverage and Other Insurance

Typically automobile dealerships allow potential customers to test drive vehicles in an effort to encourage the sale of the automobile. An interesting coverage question arises as to whether the customer's or the dealership's insurance policy applies when a customer is involved in an automobile accident. In *General Accident Insurance Co. v. Hughes*,<sup>93</sup> the owner of a dealership allowed Glowe to test drive one of its cars.<sup>94</sup> While he was test driving, Glowe collided with a vehicle driven by Crystal, injuring Crystal and causing the death of Crystal's mother, a passenger in the car.<sup>95</sup>

At the time of the accident Glowe was insured by Atlanta Casualty for up to \$25,000 per person and \$50,000 per accident, which are the minimum limits provided by Indiana's financial responsibility statute.<sup>96</sup> The dealership possessed a garage liability policy with personal injury limits of \$1 million per accident.<sup>97</sup> The garage liability policy contained a provision that provided coverage for the state's limits of financial responsibility to the dealership's customers, only if the customer had no other available insurance.<sup>98</sup>

The claimants sought a judicial declaration concerning coverage under Glowe's personal policy and the garage liability policy.<sup>99</sup> The dealership's insurer moved for summary judgment, claiming that its policy did not apply because Glowe had other insurance that satisfied the minimum financial

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89. *See id.*

90. *See id.* at 938.

91. *See id.* This ruling is contrary to the Seventh Circuit's recent ruling that a bad faith case cannot be pursued against an insurance company's employee. *See Schwartz v. State Farm Mut. Auto. Ins. Co.*, 174 F.3d 875, 878-79 (7th Cir. 1999).

92. *See Webster*, 713 N.E.2d at 937.

93. 706 N.E.2d 208 (Ind. Ct. App.), *trans. denied*, 726 N.E.2d 299 (Ind. 1999) (mem.).

94. *See id.*

95. *See id.*

96. *See* IND. CODE § 9-25-2-3(1) & (2) (1998).

97. *See Hughes*, 706 N.E.2d at 209.

98. *See id.* at 209-10.

99. *See id.* at 210.

responsibility law as prescribed in the garage liability policy.<sup>100</sup>

The trial court denied the dealership insurer's motion for summary judgment, but the court of appeals reversed holding that Glowe's personal policy with Atlanta Casualty was primary and the garage liability policy did not provide excess coverage.<sup>101</sup> This analysis is a clear and correct application of the language of the policies. Because the state's minimum financial responsibility limits were satisfied, the dealership's provisions that limited the extent of coverage were proper.

### G. Umbrella Policy Coverage for Underinsured Motorist Claim

In a case of first impression, the Indiana Supreme Court decided, in *United National Insurance Co. v. DePrizio*,<sup>102</sup> that uninsured and underinsured motorists coverage existed in an umbrella or excess policy written to provide automobile liability coverage.<sup>103</sup> The supreme court received a certified question from the Seventh Circuit, U.S. Court of Appeals.<sup>104</sup> The supreme court based its decision upon Indiana's uninsured/underinsured motorist statute and its intent:

We find that this history of expanding the availability of uninsured and underinsured motorist coverage manifests an intent by our legislature to give insureds the opportunity for full compensation for injuries inflicted by financially irresponsible motorists. To hold that an umbrella policy which by its terms covers risks above those insured in an underlying automobile policy does not apply to the underlying uninsured or underinsured motorist coverage would contravene that intent.<sup>105</sup>

With this remedial objective in mind, the court liberally construed the legislation to find that the umbrella policy provided insureds with uninsured/underinsured benefits unless the insured specifically waives these benefits.<sup>106</sup> This decision follows the trend of a growing number of states.<sup>107</sup>

### H. Set-Off in Underinsured Motorist Claim

In *Wildman v. National Fire and Marine Insurance Co.*,<sup>108</sup> the court was

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100. See *id.*

101. See *id.* at 211; see also IND. CODE § 27-8-9-10(a) & (b).

102. 705 N.E.2d 455 (Ind. 1999).

103. See *id.* at 456.

104. See *id.* Interestingly enough, the Seventh Circuit previously issued a ruling that was contrary to the *DePrizio* decision. See *Schmitt v. American Family Mut. Ins. Co.*, 161 F.3d 1115 (7th Cir. 1998). However, as Judge Hamilton of the Southern District of Indiana has noted *Schmitt* is overruled by *DePrizio* on the question of Indiana law. See *American Family Mut. Ins. Co. v. Jeffrey*, No. IP-98-1085-C H/G, 1999 WL 1893258 (S.D. Ind. Apr. 8, 1999).

105. See *DePrizio*, 705 N.E.2d at 461.

106. See *id.* at 463.

107. See *id.* at 461-62.

108. 703 N.E.2d 683 (Ind. Ct. App. 1998), *trans. denied*, 714 N.E.2d 173 (Ind. 1999) (mem.).

asked to determine what could be set-off from the amount of underinsured motorists benefits available, after the insured received worker's compensation benefits. The insured sustained injuries in an automobile/motorcycle collision while in the scope of his employment.<sup>109</sup> As a result of his injuries, Wildman received \$47,246.50 in worker's compensation benefits.<sup>110</sup> Wildman settled his claim for the underinsured third party policy tortfeasor's limits of \$100,000 and then sought underinsured coverage from National, his employer's insurer.<sup>111</sup>

An arbitrator found National was liable for \$205,000 in underinsured motorists benefits.<sup>112</sup> Based on the arbitration award, National Fire determined its payment to be \$57,753.50 by setting off the entire amount of workers compensation and tortfeasor payments issued to the insured: \$205,000 arbitration award less \$100,000 underlying coverage, less \$47,246.50 worker's compensation benefits left \$57,753.50.<sup>113</sup> Wildman argued that National should only be allowed to set-off workers compensation benefits that Wildman actually retained (\$15,748.83), after repaying \$31,497.67 toward the workers compensation carrier's lien.<sup>114</sup>

The court held that the National should only be entitled to set-off against those worker's compensation benefits that Wildman actually retained.<sup>115</sup> In arriving at its conclusion, the court found that the set-off provision in the insurance contract was ambiguous.<sup>116</sup> Consequently, the court read the set-off provision liberally so as to best serve the public interest. The court's common sense approach to the issue led to its decision that any reduction taken by an insurer should only match the amount of money the claimant actually is compensated.<sup>117</sup>

### III. COMMERCIAL AND PROPERTY INSURANCE CASES

#### A. *Standing to Contest Coverage*

Two court of appeals' cases, *Community Action of Greater Indianapolis, Inc. v. Indiana Farmers Mutual Insurance Co.*<sup>118</sup> and *Araiza v. Chrysler Insurance Co.*,<sup>119</sup> addressed the question of whether an injured party has standing to contest the coverage position taken by an insurance carrier who has a liability policy in

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109. *See id.* at 684.

110. *See id.*

111. *See id.* at 680-85.

112. *See id.* at 685.

113. *See id.*

114. *See id.*

115. *See id.* at 687.

116. *See id.*

117. *See id.*

118. 708 N.E.2d 882 (Ind. Ct. App.), *trans. denied*, 726 N.E.2d 305 (Ind. 1999) (mem.).

119. 699 N.E.2d 1162 (Ind. Ct. App.), *reh'g* 703 N.E.2d 661 (Ind. Ct. App. 1998) *and trans. denied* 714 N.E.2d 172 (Ind. 1999) (mem.).

the name of the insured tortfeasor/defendant. The cases agree on one point and conflict on another.

In *Community Action*, Community contracted with a company called Best For Less Home Improvement ("Best") to install a new roof on Community's office building.<sup>120</sup> Best subcontracted the roofing work to Lakes.<sup>121</sup> While the roofing work was being done, there was a heavy rain storm that caused about \$170,000 in property damage.<sup>122</sup>

Community Action filed suit against Best, Lakes and Lakes' liability insurer, Farmers Mutual, seeking a declaratory judgment as to whether Lakes was entitled to indemnity from Farmers Mutual for Community Action's claims.<sup>123</sup> Farmers Mutual argued that the declaratory judgment action was, in essence, a direct action against Farmers Mutual by a third party to the insurance contract and such direct actions are prohibited by Indiana law.<sup>124</sup>

The court of appeals ruled that Community Action had standing to bring the declaratory judgment action.<sup>125</sup> The court reasoned that in Indiana, as well many other jurisdictions, an injured victim of an insured's tort has a legally protected interest in the insurance policy before he reduces his tort claim to judgment.<sup>126</sup> Thus, the injured victim can assert a claim seeking a coverage determination against the defendant's liability carrier, but still cannot pursue an action against the liability carrier to establish the defendant's liability.

Shortly before *Community Action* was decided, the court in *Araiza v. Chrysler Insurance Co.*,<sup>127</sup> found that third parties could not bring an action to determine coverage prior to obtaining a judgment against the insured.<sup>128</sup> In *Araiza*, the injured third party obtained a default judgment against an insured of Chrysler Insurance Company.<sup>129</sup> After obtaining the default judgment, Araiza initiated proceedings supplemental against Chrysler to collect insurance proceeds available to cover the default judgment.<sup>130</sup> Chrysler denied that coverage was owed to its insured and also filed a declaratory judgment action in which it named its insured and Araiza as defendants.<sup>131</sup>

The trial court consolidated the proceedings supplemental case with the declaratory judgment action. Ultimately, Chrysler defaulted its insured in the declaratory judgment action, and then argued that the default against the insured

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120. See *Community Action*, 708 N.E.2d at 883.

121. See *id.*

122. See *id.*

123. See *id.*

124. See *id.* at 884; see also *Bennett v. Slater*, 289 N.E.2d 144 (Ind. Ct. App. 1972).

125. See *Community Action*, 708 N.E.2d at 886.

126. See *id.* at 885.

127. 699 N.E.2d 1162 (Ind. Ct. App.), *reh'g* 703 N.E.2d 661 (Ind. Ct. App. 1998) and *trans. denied*, 714 N.E.2d 172 (Ind. 1999) (mem.).

128. See *Araiza*, 703 N.E.2d at 662.

129. See *Araiza*, 699 N.E.2d at 1163.

130. See *id.*

131. See *id.*

barred Araiza from seeking benefits under the policy.<sup>132</sup>

The court of appeals held that the insurer's default judgment against the insured was not conclusive as to Araiza's interest in the policy.<sup>133</sup> Thus, Araiza could litigate to seek coverage for the default judgment against Chrysler's insured under the policy. The court specifically stated that Araiza "had an interest in the policy proceeds which vested at the time of the accident."<sup>134</sup>

At rehearing, the court of appeals emphasized that Araiza only had an interest in the policy and standing to sue Chrysler based upon the default judgment he obtained against the insured.<sup>135</sup> The court specifically found that direct actions by a third party against a liability insurer are prohibited, unless and until he reduces his claim to a judgment against the insured.<sup>136</sup>

The rationale of these two decisions as to whether a third party has an interest in the policy to support a direct action against the defendant's liability carrier, is clearly conflicting. As to questions of coverage, a third party seeking to establish liability should be deemed as having sufficient interest in the policy at question to permit them to be a party, either as a defendant or plaintiff, in a declaratory judgment action only. By so doing, the effect of the declaratory judgment action concerning the extent of coverage, may be conclusively established to be binding upon all.

### B. *Wear and Tear Exclusion*

During the survey period, the court in *Associated Aviation Underwriters v. George Koch Sons, Inc.*<sup>137</sup> considered an insurance policy's "wear and tear" exclusion and its application to an interesting factual scenario. Koch owned and operated an airplane and maintained an "all-risk" insurance policy<sup>138</sup> for the plane with Associated Aviation Underwriters.<sup>139</sup> Beginning in 1995, one of the airplane's engines began to exceed the maximum allowable temperature.<sup>140</sup> The problem progressed until the airplane suffered substantial property damage.<sup>141</sup>

Koch submitted a claim for the damaged engine, but the insurer denied owing any coverage because of the "wear and tear" exclusion.<sup>142</sup> During the course of

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132. *See id.*

133. *See id.*

134. *Id.*

135. *See Araiza v. Chrysler Ins. Co.*, 703 N.E.2d 661, 662 (Ind. Ct. App. 1998), *trans. denied*, 714 N.E.2d 172 (Ind. 1999) (mem.).

136. *See id.*

137. 712 N.E.2d 1071 (Ind. Ct. App.), *trans. denied*, 726 N.E.2d 312 (Ind. 1999) (mem.).

138. An "all risk" policy generally extends coverage to risks that would not be covered under standard insurance policies.

139. *See id.* at 1072.

140. *See id.* at 1072-73.

141. *See id.*

142. The exclusion provided:

This policy does not apply: . . . to physical damage . . . caused by and confined to (a)

the declaratory judgment litigation, it was established that the temperature problem was caused by the manufacturer who installed a seal ring incorrectly which prompted the engine to overheat.<sup>143</sup> Nevertheless, the insurer argued that the resulting engine damage was still caused by the wear and tear, deterioration, and mechanical breakdown of the engine while acknowledging the improper installation by the manufacturer.<sup>144</sup> The issue for resolution was whether the exclusion would apply even if the wear and tear or mechanical breakdown was caused by a third-party's negligence.

The court held that under this all-risk policy, the airplane owner was entitled to coverage.<sup>145</sup> In arriving at this conclusion, the court reasoned that the mechanical breakdown or wear and tear can be either the cause of the loss or the effect of the loss.<sup>146</sup> In this case, the wear and tear of the engine was the effect of the manufacturer's negligence rather than the cause.

*Associated* involves an interpretation of a unique exclusion under a specialized policy. However, this type of exclusion does exist within homeowners policies, and this case should be reviewed when facing a claim for "wear and tear."

### C. Effect of Release on Bad Faith Claim

The court in *County Line Towing, Inc. v. Cincinnati Insurance Co.*,<sup>147</sup> was presented with the issue of whether an insured's execution of a release of claims against the insurance company for its contractual obligations under one policy, also acts as a release of the insurance company for a bad faith tort action arising out of the claim handling. The court found that a release of the insurer's contractual obligation does not necessarily release the insurance company from an action for bad faith.<sup>148</sup>

An insured corporation owned property that housed a convenience store, a gas station, and a towing/mechanic business, all of which were damaged by a fire.<sup>149</sup> Higdon, the sole shareholder of County Line Towing, made a claim for the fire loss on behalf of the convenience store, the gas station and the towing/mechanic business.<sup>150</sup> The convenience store and gasoline businesses

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wear and tear, (b) deterioration or (c) mechanical or electrical breakdown or failure of equipment, components or accessories installed in the aircraft unless such physical damage be coincident with and from the same cause as other loss covered by this policy.

*Id.* at 1074.

143. *See id.* at 1073-74.

144. *See id.* at 1073.

145. *See id.* at 1076.

146. *See id.*

147. 714 N.E.2d 285 (Ind. Ct. App. 1999), *trans. denied*, No. 35A02-9811-CV-938, 2000 Ind. LEXIS 5 (Ind. Jan. 7, 2000).

148. *See id.* at 292.

149. *See id.* at 288.

150. *See id.*

were insured by a commercial property coverage policy, and the towing/mechanic business was covered by a garage policy.<sup>151</sup>

After the fire, Cincinnati Insurance adjusted the loss and paid under the commercial property coverage policy, but failed to pay under the garage policy.<sup>152</sup> County Line also alleged that Cincinnati Insurance unnecessarily delayed settling the claims, thereby forcing County Line to settle at a lower figure, in order to meet operating expenses of the businesses or face certain bankruptcy.<sup>153</sup>

As part of the settlement, Higdon signed a release of all claims and causes of action against Cincinnati Insurance.<sup>154</sup> When the corporation sought additional monetary compensation for Cincinnati Insurance's alleged bad faith, the insurance company filed a declaratory judgment complaint contending that it had no further obligations to County Line under either the commercial property policy or the garage policy.<sup>155</sup> County Line counterclaimed for bad faith, and Higdon, in his individual capacity, sought to intervene for the purpose of asserting his own claim for emotional distress arising out of the alleged bad faith.<sup>156</sup>

On Cincinnati Insurance's motion for summary judgment, the trial court held that County Line's counterclaim was, indeed, barred under the terms of the release.<sup>157</sup> It further held that Higdon could not bring a counterclaim because he was not a party to the insurance contract.<sup>158</sup>

On appeal, the court of appeals reversed the summary judgment by finding that the release did not bar the insured from bringing a claim for bad faith as a distinct cause of action from the underlying contractual claim.<sup>159</sup> The court further explained that a release obtained under one policy does not necessarily bar an action under a separate policy.<sup>160</sup> Thus, the insured was free to pursue its claims under the garage policy. On the other hand, the court affirmed the trial court's finding that Higdon, individually, did not have a right to maintain an action in contract or tort because he was not a party to the insurance contracts.<sup>161</sup>

#### *D. Misrepresentation on Application for Insurance*

During the 1997-98 survey period there were several cases that examined the effect of material misrepresentations by an insured in the acquisition of

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151. *See id.*

152. *See id.*

153. *See id.*

154. *See id.*

155. *See id.* at 288-89.

156. *See id.* at 289.

157. *See id.*

158. *See id.*

159. *See id.* at 292.

160. *See id.*

161. *See id.* at 296.



insurance.<sup>162</sup> In the current survey year, only one case addressed this topic. The *Foster v. Auto-Owners Insurance Co.*<sup>163</sup> decision reiterated the supreme court's decision in *Guzorek*:<sup>164</sup> a material misrepresentation on an insurance application makes the insurance contract voidable.<sup>165</sup>

However, the *Foster* decision advances *Guzorek* one step further. In *Foster*, the applicant signed multiple applications for a number of properties which he sought to be insured.<sup>166</sup> All of the applications were denied, except for one which covered a certain parcel of property.<sup>167</sup> On the accepted application, the insured indicated that he sustained no prior fire losses, which was incorrect.<sup>168</sup>

The insured sustained a fire at the covered location, and the insured's claims for the losses were denied by the insurer based upon the material misrepresentations made by the insured.<sup>169</sup> The insured sued the insurer who filed a motion for summary judgment to obtain rescission of the policy based upon the insured's material misrepresentation.<sup>170</sup> The insured argued in opposition to the summary judgment motion that the insurer was on constructive notice of the insured's previous losses based upon its receipt and denial of the other applications.<sup>171</sup>

The supreme court rejected this argument. Because the insured signed the application as containing accurate information, the court believed it would be unreasonable to expect an insurer to possess constructive notice from a few applications out of the hundreds of thousands received by the insurer.<sup>172</sup>

This case expresses the requirement that an insurance company must be given accurate and truthful information to appreciate and assess the risk to be insured. It further demonstrates that insureds, who fail to supply accurate information, will not benefit by receiving coverage.

### III. LIFE AND DISABILITY INSURANCE CASES

#### *A. Alcohol Exclusion*

In construing the applicability of an alcohol exclusion provision contained in an accidental death policy, the court in *American Family Life Assurance Co.*

162. See *Colonial Penn Ins. Co. v. Guzorek*, 690 N.E.2d 664 (Ind. 1997).

163. 703 N.E.2d 657, 659 (Ind. 1998).

164. See *Guzorek*, 690 N.E.2d at 672.

165. See *Foster*, 703 N.E.2d at 659 (citing *Guzorek*, 690 N.E.2d at 672).

166. See *id.* at 658.

167. See *id.*

168. See *id.* In fact, the insured had sustained three fire losses before submitting the application.

169. See *id.*

170. See *id.*

171. See *id.* at 660.

172. See *id.*

*v. Russell*,<sup>173</sup> liberally read the policy language to allow coverage. In June 1996, Charles Simmons was struck by a train while in his automobile.<sup>174</sup> When the police arrived at the scene of the accident, they noticed a strong odor of alcohol on Simmons' person.<sup>175</sup> Simmons was taken to the hospital where he was pronounced dead.<sup>176</sup> Simmons' blood alcohol content at the time of his death was .326.<sup>177</sup> The coroner ruled that the cause of Simmons' death was "blunt force trauma, head and chest," but the coroner also found that acute ethanol intoxication contributed to his death.<sup>178</sup> The death certificate indicated that the injury occurred when Simmons passed out on the railroad tracks and was hit by the train.<sup>179</sup>

Simmons owned an accidental death insurance policy issued by American Family Life Assurance Company ("AFLAC").<sup>180</sup> However, the policy contained an alcohol exclusion, which precluded coverage for participating in any event, including driving a car, while intoxicated.<sup>181</sup> Simmons' sister, Mary Russell, filed a claim to recover the accidental death benefits under the policy, but AFLAC refused coverage based upon the alcohol exclusion.<sup>182</sup>

Russell then filed suit alleging breach of contract and sought punitive damages for AFLAC's denial of coverage.<sup>183</sup> AFLAC filed a motion for summary judgment relying on the alcohol exclusion as the reason it denied coverage and asserting that Russell was not entitled to punitive damages.<sup>184</sup> After hearing arguments, the trial court denied AFLAC's motion on whether coverage existed, and granted partial summary judgment in favor of Ms. Russell.<sup>185</sup> The trial court, however, granted AFLAC's motion as to the claim for bad faith seeking punitive damages, and both parties appealed.<sup>186</sup>

The appellate court affirmed the trial court's decisions on both the breach of contract and the bad faith issues.<sup>187</sup> The court found that generally insurers are free to limit their liability in any way that does not violate public policy.<sup>188</sup> With that freedom, however, comes the responsibility of living with the strict

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173. 700 N.E.2d 1174 (Ind. Ct. App. 1998), *trans. denied*, 714 N.E.2d 168 (Ind. 1999) (mem.).

174. *See id.* at 1175.

175. *See id.*

176. *See id.*

177. *See id.* at 1176.

178. *Id.*

179. *See id.* at 1175-76.

180. *See id.* at 1176.

181. *See id.*

182. *See id.*

183. *See id.*

184. *See id.*

185. *See id.*

186. *See id.*

187. *See id.* at 1175.

188. *See id.* at 1177.

application of the language the insurer chooses to draft into its insurance contracts.<sup>189</sup>

The court found that the insurance policy in this case plainly stated that the insured had to be participating in an event while intoxicated in order to invoke the alcohol exclusion.<sup>190</sup> Because the undisputed evidence indicate that Simmons was passed out at the time of the accident, he was not "participating in" any event that would exclude coverage under the policy.<sup>191</sup> While the court found that AFLAC had breached the contract as a matter of law by denying coverage, it also found that AFLAC did so in good faith.<sup>192</sup> Thus, the court affirmed the trial court's summary judgment on punitive damages.<sup>193</sup>

### B. Exacerbation of Pre-Existing Condition

In *Union Security Life Insurance Co. v. Acton*,<sup>194</sup> the court of appeals examined whether an aggravation of a person's pre-existing medical condition constituted a disability that was excluded under a "pre-existing condition" provision of a policy.<sup>195</sup> In *Acton*, the insured was working as a nurse anesthetist when he was struck by an ambulance cart in the emergency room and suffered a back injury.<sup>196</sup> As a result of the accident he was placed on permanent disability.<sup>197</sup>

Acton filed a claim to collect on his Union Security disability policies. After reviewing his medical history, Union Security denied Acton's claims by contending that his disability was the result of a pre-existing condition, which was excluded under the policy.<sup>198</sup>

Acton filed suit against Union Security claiming that his disability was caused by an aggravation of his pre-existing condition.<sup>199</sup> The court of appeals agreed with Acton.<sup>200</sup> The court analyzed the exclusionary clause and found that

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189. *See id.*

190. *See id.*

191. *Id.* at 1177-78.

192. *See id.* at 1178.

193. *See id.*

194. 703 N.E.2d 662 (Ind. Ct. App. 1998), *trans. denied*, 714 N.E.2d 170 (Ind. 1999) (mem.).

195. *Id.* at 664.

196. *See id.* at 663.

197. *See id.*

198. The provision stated:

We do not cover disabilities resulting from: . . . (f) a pre-existing condition (a condition which required medical diagnosis or treatment within the 6 months immediately before the effective date and which causes a loss within the 6 months immediately after the effective date). Disability beginning 6 months after the effective date will not be considered pre-existing.

*Id.*

199. *See id.* at 664.

200. *See id.* at 664-65.

the disabling condition was not a result of the pre-existing medical condition, but occurred because of the accident which aggravated the medical condition into a disability.<sup>201</sup>

#### CONCLUSION

Unquestionably, the most notable development in insurance law during this survey period is the *Wills* decision. While the long range effect of the *Wills* decision remains to be seen, the most likely by-product of the change will be an increase in bad faith litigation in Indiana caused by insureds not being happy that their attorney is essentially an employee of their insurance company.

Several other cases decided during the survey period also dealt with bad faith claims against insurance companies. No doubt, Indiana remains a strict four-corners state, even in the context of insurance contracts. However, when faced with bad faith claims, Indiana courts seem to be asking insurance companies to interpret their insurance contracts a bit more leniently. This translates into more bad faith claims surviving summary judgment. Judicial decisions forthcoming in the next few years will be critical in developing Indiana's response to the national trend toward increasing bad faith claims.

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201. See *id.* at 664.